BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINIONS OF COURT BELOW.

The opinion in the Circuit Court (R. 200-204) dated July 18, 1941, appears in 121 Fed. (2d) Adv. Op. No. 5, page 1011.

II.

GROUNDS OF JURISDICTION.

The date of the judgment to be reviewed is July 19, 1941 (R. 204); petition for rehearing was denied August 25, 1941 (R. 219).

Jurisdiction is invoked under Section 240 of the Judicial Code, 28 U. S. C. A. 347. Writ of certiorari is sought on the following grounds:

(1) That the Circuit Court of Appeals has decided important questions of federal law which have not been, but should be, settled by this court;

(2) That said Court has decided federal questions of law in a way probably in conflict with applicable decisions of this court;

(3) That said court has rendered a decision in conflict with the decision of another Circuit Court of Appeals in respect to the mandatory application of the Chandler Act;

(4) That said court has so far departed from the accepted and usual course of judicial proceedings, both in respect to procedural matters governed by Rule 75 of the Rules of Civil Procedure for the District Court, relating to appeals, and in respect to the court's consideration of alleged facts and circumstances calling for the exercise of its equitable power, where such circumstances do not appear from the record on appeal, as to call for an exercise of this court's power of supervision; and

(5) The grave importance of the questions involved in this cause to the orderly administration of the Bankruptcy Act.

Citations of cases wherein certiorari has been granted on these grounds have been cited in the preceding petition under IV, pages 14-18, and are hereby adopted and reference made a part of this brief.

III.

STATEMENT OF THE CASE.

In this case bankruptcy was preceded by a reorganization proceeding under Section 77B. A plan was filed, confirmed, partially consummated, and then failed. Subsequently the debtor was adjudicated a bankrupt on a petition expressly praying for adjudication under Chapter X, Article XII, of the Chandler Act. The order of adjudication was not appealed. Respondents claimed the order confirming the plan was an adjudication in their favor of security which must be recognized in the subsequent bankruptcy proceeding instead of Section 64 of the Act. The Referee and District Court denied the security and allowed respondents' claims as general unsecured creditors (R. 59, 65). The Circuit Court expressly refused to decide the questions thus raised by the parties, and on equitable considerations, subordinated the claims of other creditors to those of respondents, with the practical result that respondents gained a priority even greater than they claimed to have under the plan.

The action of the court in basing its decision on equitable principles, had the effect of changing a proceeding to hear and determine the validity of secured claims to a proceeding to adjust equities on order of distribution.

The present controversy arose between the respondents and the trustee upon the hearing of respondents' secured claims, filed under Chapter X, Article XII, Section 238 (3) (R. 62-64) and the trustee's objections to such claims as secured (R. 61-62). No controversy between the respondents and general creditors was raised by the issues, nor was there any question before referee or judge as to rights of priority on order of distribution, the proceeding not hav-

ing progressed to the point where distribution was imminent.

In arriving at its conclusion, the court obviously considered as part of the record on appeal certain material not a part of the record on appeal, but appended to appellants' first brief as an appendix (R. 117-127), and as a result clearly misconceived the nature of the respective rights of the two classes of creditors as they existed prior to the confirmation of the plan.

A chronological factual statement of the case has been stated in the preceding petition under I, pages 1-9, and is hereby adopted by reference and made a part of this brief.

IV.

SPECIFICATION OF ERRORS INTENDED TO BE URGED.

1. The circuit court had no power in the circumstances of this case to create, on equitable considerations, a priority in payment not granted by statute, and the attempted exercise of such power in this case constituted a departure from the issues formed in a proceeding to consider the allowance of secured claims to a proceeding to adjust equities on order of distribution, wherein no issue had been formed and no evidence taken between respondents and other creditors; and also constituted a forfeiture of the just debts of those creditors not before the court.

2. The attempted exercise by the circuit court of its power to adjust equities between creditors upon the payment of dividends on order of distribution, constitutes an express denial of the applicable statutory provisions; i. e., Section 77B (k) (11 U. S. C. A. 207 (k)), and Chapter X, Article XII, Section 238 (11 U. S. C. A. 638), whereby Section 64 (11 U. S. C. A. 104) applies.

3. If the circuit court did have power in this controversy between trustee and respondents as secured claimants, to adjust equities between general creditors as if on order of distribution, the exercise of such power in this case was unwarranted, unjust, and inequitable. in that the result was to penalize Section IX creditors by granting to the class of creditors to which respondents belong, a priority in payment more extensive in its application to the assets of the bankrupt than could have been enjoyed by such creditors had the plan been fully consummated.

4. If the circuit court did have power, in this controversy between trustee and respondents as secured claimants, to adjust equities between general creditors as if on order of distribution, there were no facts or circumstances shown by the record, or otherwise, sufficient in law or in

equity, to require or permit the exercise by a court of equity of such power.

5. The court erred in its conclusion that the mere assertion by respondents that a trust relationship had existed between them and the bankrupt company entitled them to the special consideration of the court as a court of equity, and wholly overlooked the fact that respondents had elected to abandon the trust theory of priority by filing new secured claims based on the order of confirmation.

6. The court, though expressly refusing to determine whether a contract existed between the parties, obviously based its decision largely upon the consent of the subordinated creditors to the plan of reorganization by which respondents were granted a priority in payment; stated otherwise, the court held that the subordinated creditors were estopped to deny the priority. The court erred in finding, by inference, that an estoppel can be based on a contract which has been abrogated.

7. The court erred in refusing to determine the following specific questions raised by the parties:

(a) Whether respondents had any vested rights as preferred or priority creditors prior to the order of confirmation,

(b) Whether the order of confirmation was but a step in the reorganization proceedings, subject to modification and revocation, or was a judgment finally adjudicating the rights of all creditors.

(c) Whether the confirmed plan was a contract binding upon the creditors for all purposes, either under the provisions of Section 77B (g) (11 U. S. C. A. 207 (g)), or otherwise.

(d) Whether any lien existed in favor of respondents by virtue of the plan, the confirmed plan, the order of confirmation, or by express statute upon entry of the order of confirmation.

(e) Whether upon the entry of an order of adjudication expressly requested pursuant to the provisions of Chapter X, Article XII, which order of adjudication was not appealed, the application of said chapter and article are res adjudicata, and the application of Section 64 was mandatory or discretionary.

(f) Whether in the circumstances of this case, if the provisions of the Chandler Act are not applicable, whether Section 77B (k) is applicable and whether the application of said Section 64 is then mandatory or discretionary.

8. The court erred in refusing to decide the questions raised with respect to the enlargement of the record on appeal and in considering the appendix to appellants' first brief as a part of the record on appeal after the documents therein shown were excluded from the record.

V.
SUMMARY OF THE ARGUMENT

I. THE CIRCUIT COURT OF APPEALS HAD NO POWER IN THIS PROCEEDING TO GRANT A PRIORITY OR TO SUBORDINATE CREDITORS ON EQUITABLE CONSIDERATIONS.

(a) The Circuit Court is an appellate court and as such lacks power to depart from the issues formed below to consider equities between persons not parties to the proceedings.

(b) The Circuit Court had no greater power in any event than that possessed by a bankruptcy court, which itself has no power to create a priority or preference in payment.

(c) The exercise of equitable powers was an express denial of applicable statutory provisions.

(d) The attempt of the court to adjust equities between general creditors was unjust and inequitable in its result, and imposed a penalty on the subordinated creditors.

(e) There are no facts and circumstances in this case sufficient in law or equity to permit the exercise of the power to adjust equities, and the mere assertion of a trust relationship does not entitle respondents to special equitable consideration.

(f) Estoppel cannot be based on a contract which has been abrogated.

II. A. RESPONDENTS HAD NO VESTED RIGHT ENTITLING THEM TO PRIORITY IN PAYMENT ON ANY THEORY.

(1) Prior to the order of confirmation, because

(i) They were not secured or lien creditors and had established no priority on the trust fund theory; and

(ii) There are no vested rights in priorities under a bankruptcy act.

(2) By virtue of the order of confirmation as a judgment, because

(i) The order of confirmation in a reorganization proceeding is not the final order, as in a composition;

(ii) It is binding only in a limited sense, being subject to modification and vacation, and is only a step in the reorganization proceedings;

(iii) The court retains jurisdiction of the proceedings after entry of order of confirmation for purposes of supervision as well as other purpurposes;

(iv) Allowance of all claims in bankruptcy is subject to reconsideration and reclassification.

(3) By virtue of the confirmed plan as a contract, because

(i) The debtor had no power to make a binding contract under the circumstances;

(ii) Any contract which exists is wholly dependent upon the bankruptcy law;

(iii) Any exercise of the bankruptcy power by Congress impairs the obligation of contracts, and such impairment is not itself a denial of due process; and

(iv) Any contractual right is subject to the implied condition that the bankruptcy law may be amended or repealed.

(4) The lien claimed under the contract was subject to the same qualifications and limitations as the contract itself.

B. APPLICABILITY AND EFFECT OF THE CHANDLER ACT.

(1) It is res adjudicata.

(2) The application of Section 64 under Chapter X, Section 238, is mandatory.

III. THE COURT ERRED IN FAILING TO DECIDE THE PROCEDURAL QUESTIONS.

ARGUMENT.

I.

THE CIRCUIT COURT OF APPEALS HAD NO POWER IN THIS PROCEEDING TO GRANT A PRIORITY OR TO SUBORDINATE CREDITORS ON EQUITABLE CONSIDERATIONS.

(a) *The Circuit Court is an appellate court and as such lacks power to depart from the issues formed below to consider equities between persons not parties to the proceedings.*

The opinion of the Circuit Court reads in part as follows:

> "The appellants have provable claims within the purview of Section 63 of the Bankruptcy Act is attested by the fact that the referee allowed their claims. He denied them any lien or priority. Other-

wise stated, he decided that the claims of creditors included in Section IX of the plan should be allowed as on a parity with the claims of creditors included in Section VIII of the plan. We think this was error, and that equitable considerations require the claims of creditors of the class included in Section IX of the plan be subordinated." (R. 203.)

That respondents have provable claims under Section 63 is not denied, nor is it denied that the referee's denial to them of any lien or priority is equivalent to a finding that the claims of both classes of creditors should be allowed on a parity; the Circuit Court also found, by inference, that both classes are general creditors. But it does not follow that the referee decided that both classes should be paid equal dividends on distribution. That question was not before him, nor was it before the District Court, nor has it been submitted to the appellate jurisdiction of the Circuit Court.

Circuit courts are appellate courts; (11 U.S.C.A. 1 (3) exercising appellate jurisdiction (11 U.S.C.A. 47); district courts are courts of bankruptcy (11 U.S.C.A. 1 (10)) exercising equitable jurisdiction (11 U.S.C.A. 11).

Questions of equities between persons not parties to the proceedings in the bankruptcy court, and not presented to or ruled on by that court are not to be decided by the circuit court, as in bankruptcy proceedings its jurisdiction is purely appellate.

> *Amick* v. *Columbia Cas. Co.*, 101 Fed. (2d) 984 (8th Cir. 1939).

The Circuit Court could not in this proceeding accord priority to respondents' claims and such an order would in effect determine the ultimate rights between respondents and each of the subordinated creditors. Such evidence as appears from the record may be admissible in a later proceeding, but it is far from certain that all the evidence which the parties might be entitled to produce is to be found in the present record.

Davis v. *Louisville Trust Co.*, 181 Fed. 10 (6th Cir. 1910).

Mesker v. *Ohio Riv. Sand Co.*, 285 Fed. 379 (6th Cir. 1922).

The adjustment of equities between creditors on order of distribution, where the issues are properly formed and evidence taken on the respective rights of the general creditors, or some of them, was not the proceeding before the circuit court on appeal. The decision of that court is an improper attempt by an appellate court to act as a court of bankruptcy and to exercise the equitable powers of courts of bankruptcy.

This controversy arose on the hearing before the referee of the allowance of secured claims wherein respondents contended that they were secured by virtue of an order of confirmation entered in the preceding reorganization proceeding (R. 62-64). The trustee denied the validity of the security but admitted the existence of the claims as general claims (R. 61-62). No notice of the hearing on the claims was given to other creditors. Some of the Section IX creditors voluntarily appeared by attorneys, but took no part in the proceeding except upon the argument of the law. No testimony was offered by the respondents or the trustee and no opportunity for offering testimony was given to those general creditors who were represented. Innumerable other general creditors had no notice of the original proceeding nor were they represented at any of the hearings before the referee, district court or circuit court.

The statement of points relied on by appellants (R. 1-2) filed pursuant to Rule 13 of the Revised Rules of the Tenth Circuit (See Appendix E to this brief) raised no questions of equities between creditors, and the circuit court, by its own rule, should limit its consideration to the points so stated.

(b) *The Circuit Court had no greater power in any event than that possessed by a bankruptcy court, which itself*

has no power to create a priority or preference in payment.

The word "priority" does not refer to liens existing on the bankrupt's property, nor to the order of payment of such liens, but to the order of payment out of the general assets of an insolvent's estate on distribution after satisfaction of valid liens. Where the creditor, before the bankruptcy, has an established lien on the bankrupt's property which is not invalidated by the bankruptcy, he is a secured creditor.

6 *Remington on Bkcy.*, 4th Ed., Sec. 2839, p. 417.
Dallas v. *Ryan*, 62 Fed. (2d) 959 (5th Cir. 1933).

It is well settled that a bankruptcy court has no power to grant a priority or preference in payment because of any considerations which may appeal to it as falling within general principles of equity distribution. *So. Bell Tel. & Tel. Co.* v. *Caldwell*, 67 Fed. (2d) 802 (8th Cir. 1933), and *In re Columbia Ribbon Co.*, 117 Fed. (2d) 909 (3rd Cir. 1941).

The bankruptcy act prescribes a certain order of priority in the payment of creditors out of the net amount of the fund left after separation of property belonging to adverse claimants and lienholders, which order of priority has no reference to lien debts.

Lott v. *Salisbury*, 237 Fed. 191 (4th Cir. 1916).
Burton Coal Co. v. *Franklin Coal Co.*, 67 Fed. (2d) 796 (8th Cir. 1933).
6 *Remington on Bankruptcy*, 4th Ed., Sec. 2778, pp. 329, 330.

The power of a bankruptcy court in an appropriate proceeding to adjust equities among general creditors in the order of distribution by postponing payment of one group to payment of others is not denied, but such power must be carefully distinguished from the efforts to create a priority on equitable principles not granted by statute, in a case where the controversy arose between alleged secured creditors and the trustee as to the validity of the security.

6 *Remington on Bankruptcy*, 4th Ed., Sec. 2875, pp. 477, 483.

(c) *Exercise of equitable powers was an express denial of applicable statutory provisions.*

That the bankruptcy act requires the separation of property belonging to others, and that secured by valid lien, from the net fund to be administered for the benefit of creditors is settled. Section 64 (11 U.S.C.A. 104—see appendix C to this brief) demands the payment of creditors in a certain specified way. Assuming that under the provisions of Section 77B (k) (11 U.S.C.A. 207(k)—see Appendix B to this brief) there might have existed a right in respondents to have the court exercise in liquidation proceedings some discretionary power in the classification of claims in conformity with an equitable receivership under the equity powers of the court as in *In re Ostlind Mfg. Co.*, 19 Fed. Sup. 836 (Ore. 1937), and *In re Collins Hosiery Mills*, 18 Fed. Sup. 90 (Pa. 1937), that privilege has been expressly withdrawn by the adoption of the amendatory act, Section 238 of Chapter X (11 U.S.C.A. 638—see Appendix A to this brief). The omission in the later act of the words found in Section 77B(c)(8) (11 U.S.C.A. 207(c)(8)) "direct the estate to be liquidated" manifested congressional intent to deprive creditors of any right which they might have formerly enjoyed to have the estate liquidated in any other manner than under Section 238, whereby Section 64 is mandatory. Equitable principles may govern action in a bankruptcy court when not in conflict with the statute, but where there has been an amendment to the statute whereby such right formerly existed, there has been the equivalent of a statutory denial of the right, and any action under general principles of equity contrary thereto would be contrary to the statute and so erroneous.

In re Columbia Ribbon Co., 117 Fed. (2d) 999 (3rd Cir. 1941).

In re Carden, 118 Fed. (2d) 677 (3rd Cir. 1941).

Equitable doctrines will apply except as they are inconsistent with the act.

Local Loan Co. v. *Hunt*, 292 U. S. 234, 78 L. Ed. 1230.

Pepper v. *Litton*, 308 U. S. 295, 84 L. Ed. 281.

Securities & Exch. Com. v. *U. S. R. & Imp. Co.*, 310 U. S. 434, 84 L. Ed. 1293.

In re Columbia Ribbon Co., 119 Fed. (2d) 999 (3rd Cir. 1941).

In re Pacific Oil & Meal Co., 24 Fed. Sup. 767, 771 (D. C. Cal.).

(d) *Attempt of court to adjust equities between general creditors was unjust and inequitable in its result, and imposed a penalty on the subordinated creditors.*

Assuming that the circuit court had the power to adjust equities in this controversy, the exercise of the power by subordination of all the creditors included in Section IX to all those included in Section VIII resulted in penalizing the Section IX creditors by unjustly granting to Section VIII creditors a priority more extensive than they might have enjoyed had the plan been fully consummated. In effect, the court found that, by reason of the former proceedings in reorganization, Section VIII creditors should be allowed to keep the $11,523.00 which they have already received (R. 32), and should in addition be paid the remainder of their claims from the proceeds of all the bankrupt's real and personal property, instead of being paid merely from the proceeds of the bankrupt's real property and the income therefrom, to which they alleged they were entitled under the plan (R. 19). While this record does not show what the practical result may be, as the controversy arose before a distribution was imminent, it is apparent that under the circuit court's ruling none of the fund available for distribution may ever reach the Section IX creditors. It follows, therefore, that although they are not before the court, they have been penalized for the trustee's objection to the allowance of respondents' claims as secured claims. In such a case a court of equity should not declare a forfeiture of just debts, or, by postponing them

till all other creditors are satisfied, practically confiscate them.

U. S. Rubber Co. v. *American Oak Leather Co.*, 181 U. S. 434, 447-448, 452-453; 45 L. Ed. 938, 946, 948.

Wells v. *Lincoln*, 214 Fed. 227 (9th Cir. 1914).

Keppel v. *Tiffin Sav. Bank*, 197 U. S. 356, 49 L. Ed. 790.

(e) *There are no facts and circumstances in this case sufficient in law or equity to permit the exercise of the power to adjust equities and the mere assertion of a trust relationship does not entitle respondents to special equitable consideration.*

Assuming that in a proceeding of this kind, where no such issues have been formulated and presented as to enable the court to determine the rights of respondents against other creditors, or any of them, the record (including the purpose of this portion of the argument the material excluded by the district judge from the record on appeal (R. 117-127), is nevertheless devoid of any evidence tending to bring the subordinated creditors within the principles established by the Supreme Court and other circuit courts in cases wherein subordination has been properly ordered.

Pepper v. *Litton*, 308 U. S. 295, 84 L. Ed. 281, and *Taylor* v. *Standard Gas & Elec. Co.*, 306 U. S. 307, 83 L. Ed. 669, are cited by the circuit court as authority for subordination on equitable considerations. Careful examination of both cases discloses no circumstances comparable to this case.

In *Pepper* v. *Litton*, the question was properly up for decision by the circuit court on appeal. (See L. Ed., pp. 284-285.) Therein the claim of a dominant stockholder who had failed in his duty to the corporation, and had sought an unjust advantage, was subordinated. It was held that a bankruptcy court has power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence. It was *not* held that the court had the power to inquire into the

validity of one claim, and on that inquiry to disallow or subordinate other claims not before it (U. S. Rep., p. 305, L. Ed. 288). The entire inquiry in *Pepper* v. *Litton* relates to the disallowance or subordination on equitable principles of claims of persons who as directors or dominant or controlling stockholders have asserted an improper measrue of control over the affairs of the corporation prior to bankruptcy and whose claims must be tested by the fiduciary relationship existing between themselves and the corporation. In that case the record fairly reeked with the fraud and scheming of the claimant.

In *Taylor* v. *Standard Gas & Elec. Co.* the same principles were applied to test the claims of a parent corporation against its subsidiary, and the claims of the parent were subordinated to the claims of preferred stockholders of the subsidiary because of the history of spoliation, mismanagement, and faithless stewardship of the affairs of the fiduciary by the parent.

Bird and Son Sales Corp. v. *Tobin*, 78 Fed. (2d) 371 (8th Cir. 1935), 100 A.L.R. 654, involved the construction of Section 65a (11 U.S.C.A. 105(a)), in the light of Sections 1 and 2 (11 U.S.C.A. 1 and 11). In that case an agreement was made among certain creditors providing that in consideration of the granting of additional credit to the bankrupt company, some would agree, in the event of liquidation, to subordinate their claims to those who advanced additional credit. The court held that the contract entered into among the creditors prior to bankruptcy should be enforced. The question was raised upon the recommendations of the trustee to the referee in making the order of distribution. Due notice was given to all creditors who had filed claims (see 100 A.L.R. 655); the referee upon hearing of the trustee's suggestions adopted them and ordered the dividend to creditors who had signed the agreement to be withheld and distributed pro rata to the subsequent creditors whose indebtedness as above stated accrued subsequent to the execution of the agreement and in reliance thereupon. The District Court approved the order of the

referee and the Circuit Court of Appeals affirmed the District Court. The decision was correct. A bankruptcy court has power to adjudicate equities arising out of the relation of the general creditors with one another when the issues are formed and after due notice has been given to all creditors on the order of distribution. Following the report of this case in the American Law Reports (p. 660) is an annotation with respect to the power of a bankruptcy court to adjudicate equities among creditors in distribution of dividends. The distinction between adjustment of equities among creditors and the creation of priorities not granted by statute clearly appears from the cases therein noted.

In this case there is no evidence whatever of any legal relations, contractual or otherwise, between the two groups of creditors or any of them prior to the filing of the petition in reorganization, nor of any control over or activity in the affairs of the bankrupt company by the subordinated creditors, or any of them, either prior to filing of the petition in reorganization or since. The petition in reorganization was filed by the company, the amendments were proposed by the company, the modifications approved by the court were proposed by the company, and finally the petition asking for adjudication under Section 236, Chapter X (11 U.S.C.A. 636) was filed by the company. None of the subordinated creditors are responsible for the mismanagement of the company prior to filing of the petition, nor for either progress or failure of the proceedings subsequent thereto. Their only connection with the matter was that the required number of their group consented to the plan of reorganization proposed by the company and acquiesced in the modifications and in the order of adjudication. Respondents did likewise.

The record is also devoid of any evidence of fraud, conduct involving moral turpitude, intention to deceive, or any neglect or breach of duty on the part of such subordinated creditors or any of them, either to the respondents or to any other creditors. *Crowder* v. *Allen-West Com. Co.*, 213 Fed. 177 (8th Cir. 1914.)

The circuit court in its opinion, which for the purposes of this case must be taken to be its findings of fact, recited certain conclusions which it apparently drew from the record on appeal and the material excluded from the record but attached to respondents' first brief (R. 117-127) and from statements in that brief which are outside the record. There was no testimony before the court to form a basis for any such conclusions and at least some of them are entirely without foundation in the record. It is not denied, as stated by the circuit court, that at the time the petition was initiated respondents might have been able to establish a right to priority in payment on the trust fund theory by showing augmentation of the debtor's assets and had they succeeded in doing so certain valuable rights would have accrued to them. They might have been able to reclaim their property or money, in which event such property or money would never have become a part of the bankruptcy estate to be administered. The court states that some of these rights were or may have been lost by their acceptance of the plan. There is nothing in the record to show that any such rights were lost—in fact, had they desired to do so, they might have pressed petitions for reclamation of their funds or property under the express provisions of Section X of the plan (R. 17, pamphlet p. 7). If inferences are to be drawn from the consent of any creditor or group of creditors to the plan proposed, then the fair inference to be drawn from the consent of respondents to the proposed plan of reorganization is that they consented that their claims be paid subsequent to secured claims and expenses of administration and other priority claims mentioned in Sections I-VII of the plan (R. 17, pp. 1-5), but prior to the creditors mentioned in Section IX, because they thereby gained a priority in payment which they otherwise could not establish. Stated differently, it can be safely assumed that had they been able to trace funds and thereby remove such funds from the administration of the bankruptcy court, they would certainly have done so.

The mere assertion that a trust relationship existed between respondents and the bankrupt company did not en-

title them to any priority in payment or to any equitable consideration by the bankruptcy court.

Schuyler v. *Littlefield*, 232 U. S. 707, 58 L. Ed. 710.
In re Rosenbaum Iron Corp., 112 Fed. (2d) 315 (7th Cir. 1940).

However, it follows that since in bankruptcy all of the provisions relating to allowance of claims become applicable, that respondents still have a right to establish their rights to priority on the trust fund theory if they choose to do so, unless indeed, they have abandoned the right so to proceed by filing in the subsequent bankruptcy proceeding their new secured claims wherein no amendment of their former claims was attempted or any reference made to their prior status.

The impossibility of placing respondents in statu quo is admitted, and in that connection the fact (ignored by the court) that respondents have already received $11,523 is significant. Certainly the debtors' financial position was different on the date of adjudication from its position on the date of confirmation of the plan. Neither can Section IX creditors be placed in statu quo. Any knowledge of the possibility of failure in the consummation of the plan with which Section IX creditors are charged must also be charged to respondents as they knew equally as much of the facts and of the possible weaknesses of the plan. There is no question here involved where one group of creditors or one creditor misled others or misinformed others, and the respondents at all times had knowledge equal in extent to that possessed by the subordinated creditors.

Whatever the bankrupt may have done in violation of its legal duty to respondents, the subordinated creditors are not responsible for or bound by the consequences, and they constitute no basis of estoppel as to them. *In re Bowman Hdw. & Elec. Co.*, 67 Fed. (2d) 792 (7th Cir. 1933).

(f) *Estoppel cannot be based on a contract which has been abrogated.*

The court, though expressly refusing to decide whether

any contract existed, either under the order confirming the plan or irrespective of statute (R. 201-202) held, by inference, that an estoppel against Section IX creditors arose therefrom. This question has previously been carefully considered by the Tenth Circuit in *U. S.* v. *Golden*, 34 Fed. (2d) 367, 373, wherein it was held that, although where one has contracted in the light of certain facts, ordinarily he is estopped to deny their existence, the estoppel exists only so long as the contract, and an estoppel cannot be based on a contract which has been abrogated. The contract here, if any existed, was abrogated by the subsequent adjudication in bankruptcy, an eventuality which all parties to the contract were fully aware might occur.

II.

None of the points of law above argued was presented to the circuit court, as the question of the equities claimed to exist between the two groups of creditors was not formed as to issues, and was never seriously argued in the briefs. Such argument as there was, was directed to alleged abuse of discretion in applying the Chandler Act to the proceedings, to the end that the security claimed by respondents by virtue of the order of confirmation be allowed to them.

It follows, therefore, that since the circuit court had no power to decide the question before it on equitable considerations, or to anticipate questions which might arise on order of distribution and payment of dividends, it devolved upon that court to determine the specific questions raised by the parties bearing on the allowance or denial of the security claimed by respondents. The argument following relates to those points:

A. RESPONDENTS HAD NO VESTED RIGHT ENTITLING THEM TO PRIORITY IN PAYMENT ON ANY THEORY.

(1) *Prior to Order of Confirmation:*

Respondents have never claimed to have any liens or rights as secured creditors, by way of judgment, statute,

contract, or otherwise, on the date of filing of the petition in reorganization. That is the date as of which their rights must be fixed, as priorities not then existent cannot later arise. This is true both as to the bankrupt and among the creditors. *U. S.* v. *Marxen,* 307 U. S. 200, 207, 83 L. Ed. 1222, 1228.

Neither did respondents have any vested rights in the assets of the bankrupt except their right to be paid out of such assets, which by the filing of the petition for reorganization became in *custodia legis,* and then constituted a fund sequestered for the benefit of creditors. The mere assertion by respondents that a trust relationship existed which entitled them to reclaim money or property, is not sufficient to secure to them a preferred status. The funds must be traced.

Schuyler v. *Littlefield,* 232 U. S. 707, 58 L. Ed. 710.
American Service Co. v. *Henderson,* 120 Fed. (2d) 525 (4th Cir. 1941).
Swan v. *Children's Home Society,* 67 Fed. (2d) 84, 88 (4th Cir. 1933).

If the creditor cannot trace his property he cannot reclaim no matter what the equities are. Instead he is relegated to the position of asserting his rights as a general creditor. *In re Rosenbaum Iron Corp.,* 112 Fed. (2) 315, 318 (7th Cir. 1940).

In any event, there is no vested right in priorities under a bankruptcy act. Changes in the existing law may be made in the remedy so long as they do not affect the right.

Kuehner v. *Irving Tr. Co.,* 299 U. S. 445, 81 L. Ed. 340.
Carpenter v. *Wabash,* 309 U. S. 23, 84 L. Ed. 558.
In re Old Algiers, Inc., 100 Fed. (2d) 374 (2nd Cir. 1938).
In re Prima, 88 Fed. (2d) 785 (7th Cir. 1937).
Chelsea v. *Dolan,* 24 Fed. (2d) 522 (1st Cir. 1928, cert. den. 72 L. Ed. 1012).

Thompson v. *Siratt*, 95 Fed. (2d) 214 (8th Cir. 1938).

In re Chi., R. I. & P. Co., 90 Fed. (2d) 312 (7th Cir. 1937, cert. den. 82 L. Ed. 554), 113 A.L.R. 487.

Adams v. *Bowen*, 46 Fed. (2d) 294 (1st Cir. 1931).

Inland Dredging Corp., 61 Fed. (2d) 765 (2nd Cir. 1932, cert. den. 77 L. Ed. 985); 88 A.L.R. 254.

(2) *By virtue of the order of confirmation as a judgment:*

Did respondents acquire any vested rights by virtue of the order of confirmation as a judgment which would carry over to the date of bankruptcy, December 12, 1939, and consequently be enforceable in the present proceeding?

Such was the question certified to the district court by the referee (R. 43-44). It involves determination of the nature and effect of the order of confirmation in the reorganization proceedings (R. 21-26), which necessarily requires first an examination into the nature of a reorganization proceeding itself.

The constitutionality of the reorganization amendments to the Bankruptcy Act has been upheld on the ground that they do no more than apply the principles of composition in a way found practicable in certain instances.

Continental Ill. Nat. B. & Trust Co. v. *Chicago, R. I. & P. R.R. Co.*, 79 L. Ed. 1111, 294 U. S. 648.

In re Central Funding Corp., 75 Fed. (2d) 256 (2nd Cir. 1935).

Campbell v. *Alleghany Corp.*, 75 Fed. (2d) 947, 952 (4th Cir. 1935, cert. den. 56 S. Ct. 72).

However, it does not follow that reorganization and composition are one and the same thing for all purposes. *Callaghan* v. *RFC*, 80 L. Ed. 805, 297 U. S. 464.

One of the most important points of difference between composition and reorganization is *when* the agreement is made binding. In composition, two steps must be taken before an application for confirmation of a composition may be filed: (1) acceptance must be procured in accord-

ance with the requirements of the act; (2) the consideration for the composition, whether money or property, must be deposited in the court subject to the order of the judge. Thereupon, the order of confirmation is entered, the bankrupt revested with title to his property, and discharged of his debts. Whether a particular creditor ever receives his consideration is of no moment—his rights are determined by the entry of the order of confirmation, which is the *final* order approving and rendering effective the proposed contract among the creditors and with the bankrupt. The bankrupt has no further duties toward his creditors—he has deposited his consideration—it is out of his control —he is free of his debts.

> *In re Laubheim Bros.*, 22 Fed. (2d) 910, 911, (2nd Cir. 1937).
>
> *In re J. B. Pollak Co.*, 86 Fed. (2d) 99, (2nd Cir. 1936).
>
> *Nassau Smelting & Ref. Co.* v. *Brightwood Bronze F. Co.*, 68 L. Ed. 1013, 265 U. S. 269.
>
> *Cumberland Glass Co.* v. *DeWitt*, 68 L. Ed. 1042, 237 U. S. 447.

The entry of the order of confirmation under Section 77B (g) (11 U.S.C.A. 207 (g)) was quite different. Such order was entered after acceptance of the plan and certain other preliminary provisions had been compiled with, whereupon the debtor had then to proceed to carry out the plan and the orders of the judge. It was not by the order of confirmation relieved of further obligations to its creditors nor to the court; it had not parted with any specified sum of money or parcel of property as the consideration for its discharge on confirmation of the proposed plan; it was still subject to certain obligations to consummate the plan proposed; upon fulfillment of such obligations, a report had to be made to the court, and then, and only then, a *final* order was entered closing the case and discharging the debtor from its debts, except as provided in the plan.

The nature of an order of confirmation has been considered by this court which decided as follows:

> "* * * an order confirming a plan of reorganization under Sec. 77B is not the equivalent of a judgment granting or denying a discharge, for unlike confirmation of a composition, see (July 1, 1898) Sec. 14, 30 Stat. at L. 544, 550, chap. 541, U.S.C.A. title 11, Section 32 (c) it does not operate as a discharge. The release of the debtor in a reorganization proceeding is contingent upon the performance of its part of the reorganization plan. Section 77B (h) commands the debtor and others to execute the plan of reorganization, when confirmed, under the direction of the court, authorizes the court to make appropriate orders to that end, and provides that 'upon the termination of the proceedings a final decree shall be entered,' which 'shall discharge the debtor from its debts and liabilities.' Discharge is effected not by confirmation of the plan but by the final decree." *Meyer* v. *Kenmore Granville Hotel Co.*, 80 L. Ed. 557, 560, 297 U. S. 160.

Upon confirmation in reorganization, the plan is said to be "binding upon all creditors" (Sec. 77B, subd. g), but this, of course, is subject to the right of subsequent modification of the plan (subd. f) upon proper notice and after opportunity is afforded for withdrawal of acceptance by any creditor who has previously accepted the plan. It is apparent, then, that the order of confirmation "binds" the creditors only in a limited sense, and that it is the final decree provided by subd. (h) that closes the case and finally fixes the rights of the parties.

The order of confirmation is but a step in the reorganization proceedings:

> *Meyer* v. *Kenmore Granville Hotel Co.*, 80 L. Ed. 557, 560; 297 U. S. 160
>
> *In re Eastern Utilities Inv. Corp.*, 98 Fed. (2d) 620, 623 (3rd Cir. 1938)

Wright v. *City Nat'l Bank*, 104 Fed. (2d) 285 (6th Cir. 1939)

Campbell v. *Allegheny Corp.* 75 Fed. (2d) 947, 955 (4th Cir. 1935)

and is not a final judgment fixing creditors' rights. The court of the Tenth Circuit has cited as authority two of the cases above mentioned, with specific reference to the possibility of subsequent modification of a confirmed plan. *In re Deep Rock Oil Corp.*, 113 Fed. (2d) 266, 269 (1940).

Possibility of modification is an important element to be considered as bearing on the nature of the order of confirmation. Such a modification of this plan was actually effected once (April 17, 1939, *after* the Chandler Act became effective, and pursuant to it), upon appropriate notice to creditors (R. 26-29). The provisions of both acts respecting modification are copied in appendices A and B to this brief.

Both Sections 77B and Chapter X of the Chandler Act clearly distinguish between confirmation and consummation. The word "consummation" is not used in Section 77B but the words "carry out" are used. Careful reading and comparison of the two acts show that the order of conrmation was never by either intended to fix the rights of the parties except subject to the carrying out, completion, or consummation of the plan of reorganization in accordance with its terms and the orders of the court. Both acts subject the debtor to the continued jurisdiction of the court, both acts direct proceedings in the same fashion as to the appointment of a trustee, filing and classification of claims, etc. *Wiggin Terminals* v. *Hassett*, 35 Fed. Sup. 654 (Mass. 1941).

In this case the district judge specifically reserved jurisdiction for many purposes in the order of confirmation, including the power to liquidate the estate in the event of the failure of the plan (R. 25), thereby intentionally limiting the binding effect of the order.

The distinction between preliminary or administrative orders and final decrees in reorganization proceedings has been consistently recognized:

National Lock Co. v. *Hogland*, 101 Fed. (2d) 576 (7th Cir. 1938)

In re Corona Radio and Television Corp., 102 Fed. (2d) 959 (7th Cir. 1939)

In re Paramount Publix Corp., 82 Fed. (2d) 230 (2nd Cir. 1936)

In re Mallow Hotel Corp., 29 Fed. Sup. 931 (Pa. 1939)

Mohonk Realty Corp. v. *Wise*, 111 Fed. (2d) 287 (2nd Cir. 1940).

The bankruptcy court can alter its administrative decrees in aid of creditors or of the debtor where no intervening rights of innocent third parties (of whom we have none here) have been or are likely to be materially interfered with, and could abrogate a rental purchase lease notwithstanding the fact that it had previously approved it. *In re Roger Williams Bldg. Corp.*, 99 Fed. (2d) 212 (7th Cir. 1938), cert. den. 59 S. Ct. 1032.

Section 57k of the Bankruptcy Act is applicable both under Section 77B and the Chandler Act. It specifically gives the bankruptcy court the power to reconsider claims, which power may be exercised *sua sponte*, upon the application of another creditor, the trustee, or even the bankrupt. This power to reconsider and reclassify claims is thoroughly recognized. *Pepper* v. *Litton*, 308 U. S. 295, 305, 84 L. Ed. 281, 288.

On the theory that the allowance of a claim in bankruptcy is a judgment, the allowance of respondents' claims for payment under Section VIII of the plan was subject to reconsideration and reclassification, in which event the law as it existed at the time of the reconsideration would apply. *U. S.* v. *Heinszen*, 206 U. S. 370, 51 L. Ed. 1098.

(3) *By Virtue of the Confirmed Plan as a Contract:*

Any contract right which may have arisen as of April 2, 1937, the date of confirmation of the plan, or prior thereto by virtue of the proposed plan and its acceptance, must necessarily be considered in the light of the bankruptcy law pursuant to which such contract, if any, was made. A corporation debtor which has subjected itself to the jurisdicetion of the court for the purpose of procuring a reorganization but which, as a result of its submission to jurisdiction, may suffer an adjudication in bankruptcy instead, cannot make any valid contracts with its creditors except in accordance with the statute and with the express consent of the court. *Case* v. *L. A. Lbr. Prod. Co.*, 84 L. Ed. 110, 126, 127, 308 U. S. 106. Hence, it follows that if any contract exists, it exists not irrespective of statute, but by virtue thereof.

Assuming, however, that a valid contract was created by virtue of the offer of the plan, its acceptance, and the entry of order of confirmation it was at all times subject to possible subsequent impairment by some exercise of the bankruptcy power, either pursuant to then existing statutes or pursuant to such amendatory acts as might by Congress be adopted.

Any exercise of the bankruptcy power impairs the obligation of contracts and such impairment is not itself a denial of due process.

> *Campbell* v. *Alleghany Corp.*, 75 Fed. (2d) 947, 953 (4th Cir. 1935, cert. den. 56 S. Ct. 92).
>
> *Kuehner* v. *Irving Trust Co.*, 299 U. S. 445, 81 L. Ed. 340.

> "No person has a vested interest in any rule of law entitling him to insist that it shall remain unchanged for his benefit. Munn v. Illinois, 94 U. S. 113, 134, 24 L. Ed. 77; New York Central R. Co. v. White, 243 U. S. 188, 198, 37 S. Ct. 247, 61 L. Ed. 667, L.R.A. 1917D, 1, Ann. Cas. 1917D, 629. . . . The leg-

islation being a proper exercise of the bankruptcy power, there is no merit in the objection it affects obligations incurred before its enactment. Canada Southern Ry. Co. v. Gebhard, 109 U. S. 527, 539, 3 S. Ct. 363, 27 L. Ed. 1020; Continental Illinois Nat. Bank v. Chicago, Rock Island & P. Ry. Co., 294 U. S. 648, 674, 55 S. Ct. 595, 605, 79 L. Ed. 1110; United States Nat. Bank v. Pamp, 8 Cir., 77 Fed. (2d) 9, 99 A.L.R. 1370; Campbell v. Alleghany Corp., 4th Cir., 75 Fed. (2d) 947." *Thompson* v. *Siratt*, 95 Fed. (2d) 214, 217, 218.

* * * * *

"All parties to a contract are, of necessity, aware of the existence of, and subject to, the power of Congress to legislate on the subject of bankruptcies. They were or are chargeable with knowledge that their rights and remedies, in case the debtor becomes insolvent and is adjudicated a bankrupt, are affected by existing bankruptcy laws and all future lawful bankruptcy legislation which might be enacted. The amendments to the bankruptcy laws were not therefore necessarily an unlawful impairment of the contractual rights of either party. All loans were made and all credit extended with the knowledge that the power to enact such laws existed and application of such legislation might alter the contractual rights of the creditor. To illustrate: A discharge in bankruptcy is the goal of the debtor in the ordinary bankruptcy proceedings, yet, a discharge of debts necessarily abridges the creditor's contract and his rights thereunder. *Another unavoidable conclusion is that all contracts are made with the knowledge that existing bankruptcy laws may be amended.*

". . . In fact, the entire bankruptcy act might be repealed and no vested right invaded." *In re Prima Co.*, 88 Fed. (2d) 785, 788 (7th Cir. 1937). (Italics ours.)

(4) *The lien claimed under the contract was subject to the same qualifications and limitations as the contract itself:*

If a lien was established by the contract approved by the order of confirmation, it was at all times subject to the limitations of the plan, the reservations in the order confirming it, and to the implied condition that the bankruptcy law might effect changes in its enforcement.

Kuehner v. *Irving Trust*, 299 U. S. 445, 81 L. Ed. 340.

Ginsberg v. *Lindel*, 107 Fed. (2d) 721 (8th Cir. 1939).

In re Chicago, R. I. & P. Co., 90 Fed. (2d) 312, 316, 113 A.L.R. 487 (7th Cir. 1937).

Such a lien was necessarily dependent upon the ability of the debtor to effectuate the whole plan, not merely a part of it; it was granted in contemplation of complete reorganization.

Failure of the court to determine whether any lien or security existed, and to define its nature, leaves undecided vital questions of interpretation of the reorganization sections of the bankruptcy act, properly raised in this proceeding, the determination of which is necessary to the proper administration of the estate, upon which the Supreme Court has not as yet expressed its views.

B. APPLICABILITY AND EFFECT OF THE CHANDLER ACT.

(1) *Its applicability is res adjudicata:*

The petition for adjudication was filed pursuant to the provisions of Chapter X, Article XII, of the Chandler Act. By filing such petition the debtor took advantage of procedure thus made available to it which possibly had not before existed. All persons in interest were notified, and although no written response was made to the show cause order (R. 35) "after several postponements the matter came on for hearing on December 12, 1939, and upon full

hearing" (R. 39) the order was entered. No appeal was taken and the question of the applicability of the Chandler Act to the pending proceeding is res adjudicata. It was expressly made applicable by the order of adjudication which by its terms is based on the petition requesting adjudication under Article XII of the Chandler Act (R. 36).

No question of abuse of discretion by the district judge in rendering this particular provision of the Chandler Act applicable to the pending reorganization proceeding is open to argument, the order not having been appealed from. Therefore, there is no question of applicability under Article XVI, Section 276c, of the Chandler Act; the remaining question is as to the *effect* that the order of adjudication has on such rights, if any, as may have been acquired in the reorganization proceeding (R. 39-41).

(2) *The application of Section 64 is mandatory:*

So far as effect is concerned, analysis of Section 77B establishes that appellants had no greater or different rights under that amendatory act than they have under the present Chandler Act, also amendatory.

Section 77B (a) (11 U.S.C.A. 207(a)) provided, among other things, that upon the approval of the filing of a petition the court should during the pendency of the proceedings have exclusive jurisdiction of the debtor and its property and "shall have and may exercise all the powers, not inconsistent with this section, which a federal court would have had it appointed a receiver in equity of the property of the debtor by reason of its inability to pay its debts as they mature." Chapter X, Article III, Section 115 (11 U. S. C. A. 515), is substantially identical.

Section 77B (c) (8) provided that if a plan was not proposed and accepted, or not confirmed, the judge might, after hearing, extend the period, dismiss the proceeding, or direct the estate to be liquidated, which liquidation would have to proceed as in Section 77B (k), which pro-

vided, among other things, that "debts *shall* be entitled to priority as provided in Section 64." Certain other sections of the bankruptcy act relating to appointment of trustee, etc., were especially made applicable, and "the date of the order approving the petition or answer under this section shall be taken to be the date of adjudication, and such order shall have the same consequences and effect as an order of adjudication." Chapter X, Article XII, Sec. 236(2), and Sec. 238 (11 U.S.C.A. 636, 638) are substantially identical, except that the words "or if a confirmed plan is not consummated" have been added. The general method of procedure prescribed for the future administration of the estate is the same, whether it is called "liquidation" in the first act, or "procedure in bankruptcy" in the second. The same provision is retained as to the effective date of the "adjudication," except that in the latter act the effect is qualified by the substitution of "shall as far as possible" for "shall" in Section 77B.

The application of the provisions of Section 238 is mandatory in a situation where reorganization has failed.

In re Columbia Ribbon Co., 117 Fed. (2d) 999 (3rd Cir. 1041).

In re Calif. Pea Pro. Co., 37 Fed. Sup. 659, 661 (Cal. 1941).

In re Centralia Ref. Co., 35 Fed. Sup. 599, 601-2 (Ill. 1940).

Hi-Flier Mfg. Co. v. *Haberman*, 115 Fed. (2d) 918 (2nd Cir. 1940)

Under Section 77B there might have been two methods of liquidation. *In re Ostlind Mfg. Co.*, 19 Fed. Sup. 836 (Ore. 1937) proceedings were had in conformity with an equitable receivership rather than in accord with Section 77B (k). The court expressly disapproved the procedure.

In re Collins Hosiery Mills, Inc., 18 Fed. Sup. 90 (Pa. 1937), contains an analysis of the manner of liquidation under Section 77B which the court considered open to the judge. The conclusion was that two methods were available: (1) liquidation under the equitable powers of the court;

and (2) a liquidation under creditor control following the procedure set forth in subdivision (k). The court says the liquidation under (1) should take place only where exceptional circumstances demand it.

Chapter X, Article XII, Section 238 (11 U.S.C.A. 638), deprives the court of the first method of liquidation.

Application of Section 64 under 77B (k) is mandatory.

In re Manhattan Music Hall, 14 Fed. Sup. 48 (N. Y. 1936).

Miners Sav. Bank v. *Joyce*, 97 Fed. (2) 973 (3rd Cir. 1938).

In re Higgin Mfg. Corp., 19 Fed. Sup. 120 (Ky. 1937).

Application of Section 64 under Chapter X, Article XII, Section 238, involves no exercise of discretion of the court because of the use of the words "so far as possible." "Possible" does not mean the same thing as "practicable." *In re Kenilworth Bldg. Corp.*, 105 Fed. (2d) 673, 676 (7th Cir. 1939). It is possible to apply Section 64 to the payment to creditors of funds arising from assets of the bankrupt corporation which are still in the hands of the trustee, and there is no question of practicability here. Compare *In re Manhattan Music Hall*, 14 Fed. Sup. 48, 52, and *In re Old Algiers*, 100 Fed. (2d) 374 (2nd Cir. 1938).

It should also be noted that Section 238 (3) absolutely limits the claims which shall be provable to those provided by Section 63, which would naturally have the effect in some cases of denying any participation whatever to creditors in the subsequent bankruptcy proceedings on account of claims which might have been proved and allowed for payment in a plan confirmed in a prior reorganization proceeding. Congress allowed no discretion to the court to determine what was either practicable or possible in the application of Section 63, and it follows that it intended no discretion to exist as to Section 64. Section 238 is explicit and mandatory and the court has no discretion to act con-

trary to its terms. Compare *Carpenter* v. *Wabash*, 309 U. S. 23, 84 L. Ed. 558.

III.

THE COURT ERRED IN FAILING TO DECIDE THE PROCEDURAL QUESTIONS

Respondents in their Designation of Record on Appeal filed in the district court (R. 66-67), included the material which they have appended to their brief as an appendix (pp. i-xi) (R. 117-127). The four papers which they have thus attempted to include in the record to be sent to this court were not considered by the referee, were not certified by him to the district court, and were not considered by the district court on petition for review, as is apparent from the referee's Record on Petition for Review (R. 41-43) and from Motion for Submission of Record on Appeal to the District Court (R. 69). The first four of such papers relating to the particular claims of Minnie C. Hanssen and Thyra H. Mankin (R. 66, Items 4, 6, 7, and 8) were not filed in the office of the clerk of the district court but were part of the files in the office of the referee, as appears from the certified copies thereof (R. 117-122). There is nothing in the referee's opinion (R. 44-59) to indicate that the referee considered these documents, though he does (R. 45-46) describe the *claims* filed by these particular creditors.

The trustee's motion to settle the question of whether such papers should be included in the record on appeal (R. 69) was filed on the theory that respondents were attempting to enlarge the record by bringing to the attention of the circuit court material not included in the record on review and not considered by the district judge.

The bankruptcy rules of this district provide:

> "Petitions for review of all orders of the referee shall be accompanied by a praecipe setting out in detail the record to be sent up for review, including a statement of the evidence desired to be sent up, and all exhibits, books, and other documents re-

quired to be sent; and petitioner shall at that time or such time as he may be notified by the referee of the amount of costs required, pay for making such record, transcript or documents." Rules of the U. S. Dist. Court, District of Colo., Rule 13, Sec. 1.

Such rules, adopted pursuant to General Order No. 37 and Rule 83 of the Rules of Civil Procedure, where not inconsistent with the Bankruptcy Act, the General Orders and the Rules of Civil Procedure, have the effect of law.

Weil v. *Nary*. 278 U. S. 160, 73 L. Ed. 243, 249.
Bronx Brass Foundry, Inc., v. *Irving Trust Company*, 297 U. S. 230, 80 L. Ed. 657.

Rule 75(h) of the Rules of Civil Procedure provides that while it is not necessary for the record on appeal to be approved by the district court or judge, if any difference arises *as to whether the record truly discloses what occurred in the district court*, the difference shall be submitted to the court and *the record made to conform to the truth*. Logically, this must mean that the judge may exclude from the designated record on appeal any pleadings, documents, transcript or other material which is actually not a part of the record in his court.

At the time the matter was brought up to the district court from the referee on petition for review, the respondents themselves did not regard as relevant the material which they later presented as an appendix to their brief. If every appellant in a bankruptcy matter were permitted, after having his contentions denied by the district court on petition for review, to reach back into the files of the referee and extract therefrom such additional matter as he believed might improve his case on appeal to the circuit court, right of review by the district court would be destroyed and there would be no point in requiring litigants to have their controversies heard by the district court before presentation to the circuit court of appeals. What was appealed to the circuit court was the order of the district court and the record was the record of the district court. As a matter of practice, if appellants are entitled to sup-

plement their record from the referee's office, then appellees would be entitled to the same privilege, and the result would be new cases in the circuit made up from the files of the referee.

The trustee also objected to the inclusion of these documents in record on appeal because Items 4, 6, 7, and 8 relate only to one of the claims from the disallowance of which this appeal is taken. He denies that such documents accurately reflect the facts with respect to the claims of *all* of the respondents, nor of the claims of *all* of the Section VIII creditors. Respondents are not all of such creditors; they represent the majority in amount, but not the majority in number R. 31-32).

The power of the district court to determine such questions has been affirmed in the only case directly touching on the point, wherein it was stated that that court could better determine the facts than the circuit court. *Reynolds* v. *Imlay*, 118 Fed. (2d) 53 (C.C.A., D. C., 1941).

No motion for an intermediate order touching this matter was made in the circuit court by respondents, nor was certiorari for diminution of the record sought. See Rule 75 (h) and (j), Rules of Civil Procedure for the District Courts, and Rule 13 of the Revised Rules of the Tenth Circuit, appended hereto as an appendix at pages 62-63.

Addition to the record on appeal of the documents described tended to confuse the record, and raised in the circuit court a basis of claim which was not mentioned in the claims as filed (R. 62-63). The nature and status of respondents' original claims sufficiently appear from the findings and decision of the referee (R. 45-46).

The circuit court obviously considered the excluded material in arriving at its conclusions with respect to the equities which it has stated existed in favor of respondents, with the result that it has greatly exceeded its powers as an appellate court in subordinating certain creditors in a

proceeding initiated solely to determine the allowance of secured claims.

We ask that a writ of certiorari be granted and that upon final hearing the judgment of the circuit court be reversed.

Respectfully submitted,

JOHN W. SHIREMAN,
NORMA L. COMSTOCK,
NORMAN H. COMSTOCK.

Denver, Colo., Sept. 30, 1941.